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IN THE

Supreme Court of the United States

OCTOBER TERM, 1941

No. 133

ROBERT H. CORY,

Petitioner,

—*against*—

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT THEREOF

PETER V. D. VOORHEES,
SAMUEL B. STEWART, JR.,
Counsel for Petitioner.

Hallsby Press, New York City

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To the Honorable, the Chief Justice and Associate Justices of the Supreme Court of the United States:

PETITION.

Your petitioner, Robert H. Cory, respectfully shows:

This is a petition for a writ of certiorari to the United States Circuit Court of Appeals for the Third Circuit to review a decision affirming a decision by the United States Board of Tax Appeals finding deficiencies in your petitioner's income tax for the years 1935 and 1936 in the respective amounts of $3,802.02 and $9,074.76.

I.

STATEMENT OF FACTS.

[Otherwise unidentified numbers in parentheses refer to pages of the Record.]

This case arises out of the creation by the petitioner of four trusts of securities for the primary benefit of the petitioner's wife and three sons, respectively. The order below is based upon a finding that the trust income should be taxed to the grantor for two years of a ten year period after the trusts had been made irrevocable except with the consent of the beneficiaries.

On April 6, 1929, the petitioner (hereinafter called "Cory") created the trusts in question, with Clinton H. Blake as sole trustee (6). The original trust instruments reserved to Cory a limited right to amend or revoke the trusts (Exhibits B, C, D and E, 26-44), but on January 8, 1935, Cory amended each of these trusts so as to provide that it should continue for a further maximum period of ten years from that date, should be absolutely irrevocable except with the consent of the beneficiary and that on termination the principal should be distributed to Cory or his estate (Exhibits H, I, J and K, 45-53).

The Commissioner Admits He Originally Determined Deficiency on Erroneous Basis.

The Commissioner originally determined deficiencies in Cory's income tax liability for the years 1935 and 1936 by treating the income of these trusts as taxable to Cory by virtue of Section 166 of the Revenue Acts of 1934 and 1936, on the theory that Cory's remainder interest in each trust was equivalent to the retention of power to revest title in

himself (24, 62), but at the hearing in the Board of Tax Appeals the Commissioner admitted that he had been in error in his theory that the trusts were revocable trusts, and moved to amend his answer to claim that the deficiencies should have been determined on the ground that Cory was the beneficiary of the trusts and that the income was taxable to him under Section 22(a) of the Revenue Acts of 1934 and 1936 (72-74). This motion was granted.

Cory's reply to the amended answer in each case admitted the Commissioner's allegation that the original determination was erroneous, but denied that the petitioner was the beneficiary or owner of the trusts so as to be taxable under Section 22(a) of the Revenue Acts of 1934 and 1936 (74-75).

The Commissioner Had the Burden of Proof.

In accordance with Rule 32 of the Rules of the Board of Tax Appeals, both the Board and the Circuit Court of Appeals ruled (76, 110, 117) that the Commissioner, having pleaded an affirmative issue, had the burden of proof in establishing taxability of the income to Cory under Section 22(a).

Commissioner's Evidence.

The Commissioner presented no evidence other than copies of the trust instruments and the amendments thereto (78-80).

Cory's Evidence.

Cory presented the following evidence: (1) that he had filed a gift tax return for the year 1935 in which he had set forth the facts as to the amendment of the trusts in 1935, but had denied that such amendments effected taxable

gifts (81-83; Pet. Ex. 1, 92-95); (2) that the Commissioner had made a determination of gift tax liability by reason of the amendment of the trusts (83-84; Pet. Ex. 2, 96-103); (3) that the gift tax had been assessed and paid pursuant to the Commissioner's determination (86, 104); and (4) that no suit for refund of the gift tax paid had been instituted by Cory (86). Cory's counsel offered to stipulate the facts as to the distribution of the income of the trusts, but the Commissioner declined to accept the offer (87).

Since the burden of proof was on the Commissioner, it follows that all facts as to which the record is silent should have been assumed by the Court to be favorable to Cory.

Unsupported Inferences by the Circuit Court of Appeals.

While expressly adopting our contention and approving the ruling of the Board that the burden of proof was on the Commissioner, the Circuit Court of Appeals in its opinion placed great emphasis on assumed facts which find no support in the record. In other words, after stating one rule,—the correct rule—that the burden of proof was on the Commissioner in the circumstances here disclosed, the Court below, in effect, applied a different rule,—a rule that if the Commissioner proved the existence of trusts in which a taxpayer had a reversionary interest and in which income was to be paid to or accumulated for persons related by blood or marriage to the taxpayer, the Court would infer the existence of all the other facts held by this Court to be necessary to justify a finding of taxability, unless the taxpayer should then go forward with evidence to contradict such inferences.

The Court thus inferred, utterly without support in the record, that: (a) "the taxpayer retained complete control over the trustee who was also apparently his attorney" (115), and (b) "the trust just as in the *Clifford* case merely

reallocated the income within an 'intimate family group' " (115).

This Court has held each of these factors to be important in making a determination of taxability in a case of this kind. Yet, as pointed out in our brief, the decision here as to what constitutes an "intimate family group" is completely inconsistent with the decisions in other Circuits, and the determination of "control" over the trustee is based upon an unwarranted inference from an unproved fact.

Provisions of the Trust Instruments.

The trust for Mrs. Cory provided that the income be distributed to her or accumulated for her in the sole discretion of the trustee and that any accumulated income should be paid to her not later than upon the termination of the trust or to her estate in the event of her death (26).

The trusts for Cory's three sons were identical in form and provided that the trustee should apply so much of the income (originally subject to certain limitations as to maximum amounts) as the trustee should see fit to the use of each of the sons, and that the income not so disbursed should be distributed to or accumulated for Mrs. Cory in the sole discretion of the trustee (36).

In all of the trust instruments, the trustee was given broad investment authority, subject only to Cory's reserved right (which was never exercised) to direct investment changes and the issuance of voting proxies (29, 38). Cory reserved no right to remove the trustee or to appoint another trustee except in the event of the original trustee's death or resignation (30, 40). The trustee neither died nor resigned. Except for the requirement that stock dividends be treated as principal, the trustee had absolute and uncontrolled authority to determine what receipts should be credited to income or principal and what expenses should be charged against either income or principal (31, 40-41).

The 1935 amendments to the trusts, which made them absolutely irrevocable (except with the consent of the beneficiaries) for an additional period of ten years, also provided that upon termination of each trust the principal would be distributed to Cory or his estate, and that Cory would have the right to change administrative provisions, but not to change the distributive provisions or affect the beneficial interests except with the consent of the beneficiaries (47, 51). The record fails to show that Cory ever exercised even the power to change administrative provisions. Nor did he in fact ever do so. All of the amendments to the trusts were placed in evidence and there were no amendments subsequent to January 8, 1935.

This reserved, but unexercised, power to change administrative provisions was the occasion for a serious error in the opinion of the Court below. The opinion relies heavily on the unsupported observation (115) that:

> "* * * he (Cory) could control the purse strings through his power to change, modify or alter any of the administrative provisions of the agreement. By this provision the settlor subtly reserved complete dominion over the trustee, since the trustee's appointment and powers are administrative."

The extent of this unexercised power is more fully analyzed in the supporting brief, but the unjustified character of the quoted conclusion is shown when we note that a maximum exercise of the power to change administrative provisions could not possibly alter the disposition of even a penny of either income or principal. Cory, therefore, certainly did not "control the purse strings". Yet this obvious error was a keystone of the Circuit Court's opinion.

II.

Jurisdiction.

The final decree of the Circuit Court of Appeals is dated March 12, 1942 (118). Petition for certiorari is brought pursuant to Section 240(a) of the Judicial Code, as amended by the Act of February 13, 1925 (Act of Cong. Feb. 13, 1925, c. 229, §1; 43 Stat. 938; 28 U. S. C., §347).

III.

Question Presented.

The sole question on this appeal is whether the Circuit Court of Appeals was justified in deciding that the "benefits" retained by the grantor were such that he remained in substance the owner of the trust property and therefore taxable on the income thereof, the burden of proof on this issue being on the respondent (the Commissioner).

This question requires a consideration of the subordinate questions, whether the rule enunciated by this Court in *Helvering* v. *Clifford*, 309 U. S. 331, should be extended to require taxability to the grantor of income from a trust (a) where the trust is irrevocable for ten years; (b) where the grantor is not the trustee, is not related to the trustee and has no control over the trustee; (c) where the grantor has no control over the distribution of income of the trust, and the independent trustee has absolute authority (1) to change investments without seeking the approval of the grantor, (2) to determine all questions of what should be credited to or charged against income or principal accounts, (3) to decide whether or to what extent income should be distributed to or accumulated for the beneficiaries (such decision in the case of three of the trusts affecting the question

of who would ultimately receive the income); (d) where the only permissible inference from the evidence is that the sons (for whose benefit three of the four trusts were created) were adult, emancipated and not members of an "intimate family group" as that term is commonly understood; (f) where approval of the rule enunciated by the Circuit Court of Appeals will effectively change the rule declared by this Court in the *Clifford* case as it has been generally understood and applied by other Circuit Courts of Appeals and by members of the Bar.

IV.

Reasons for Granting the Writ.

(1) ***The Decision of the Court Below Is in Substantial Conflict with the Reasoning of This Court in the Leading Case of Helvering v. Clifford, 309 U. S. 331, the Cases Following That Decision, and the Language of the Federal Statute on Which They Are Based.***

In the *Clifford* case, this Court announced a broad extension of the previously understood limits of liability under Section 22(a) of the Revenue Act of 1934,—an extension which the Commissioner of Internal Revenue himself had not even sought—an extension which prompted the dissenting minority to state that the decision disregarded "the fundamental principle that legislation is not the function of the judiciary but of Congress" (309 U. S. at 338). Yet, even under that extension of the rule, the majority went no further than to hold trust income taxable to the grantor in cases where, as in that case, "the benefits directly or indirectly retained blend so imperceptibly with the normal concepts of full ownership" that it is reasonable to find that the grantor "was the owner of the corpus for the

purposes of Section 22(a)". A finding that Cory continued to be the full owner of the trust property here involved violates all recognized principles of our property law. The trusts here were irrevocable for ten years (double the term involved in the *Clifford* case) unless sooner terminated by the death of the grantor or the survivor of four other persons. One trust was for the wife, as in the *Clifford* case, but the other three were for sons of the grantor, who, in spite of unwarranted inferences in the opinion below, must be regarded as emancipated adults who were no longer members of the grantor's "intimate family group".

The trustee here was independent (in contrast to the situation in the *Clifford* case where the grantor himself was trustee) and not subject to the control of the grantor except in minor ways which did not affect the absolute and irrevocable rights of the beneficiaries. The grantor's unexercised right to control investments was a reserved power which afforded the grantor only a modicum of protection against complete waste by the trustee of any principal that might revert to the grantor after ten years,—a period which was destined to include several years of world financial depression and additional unknown years of world conflict. The depression alone would have been enough to render any hope of reverter insecure; the addition of years of war—even successful war—may well make a reversion in 1945 utterly without value.

Section 22(a) permits taxability of trust income to the grantor only if the property producing the income is in effect owned by the grantor and that was the theory of this Court's decision in the *Clifford* case. Accordingly, the decision below can be justified only if the following proposition is correct: that a mere right of reverter in assets which, after a decade such as that in which we are now living, may have little or no value, plus an unexercised power to direct changes in investments, plus the satisfaction of benefiting independent blood relatives during the ten year

period, "blend so imperceptibly with the normal concepts of full ownership in the grantor" that he must be treated as the absolute owner.

(2) *This Case Involves Important and Novel Questions of Federal Law Which Have Not Been, but Should Be, Decided by This Court.*

The Court below expressly recognized (110) that it was handicapped in correctly determining the issues of this case by "the fact that the Supreme Court's decision (in the *Clifford* case) merely roughed in the broad outline of taxability and left the completion of the picture to future decisions". Indeed, the Court below placed considerable emphasis upon the unsettled limits of the rule in the *Clifford* case concerning which it quoted one writer to the effect that: "few tax problems in recent years have caused as much litigation as this one decision" (110).

The Circuit Court of Appeals for the First Circuit has also recently commented upon the need for further interpretation by this Court of the scope of the rule enunciated in the *Clifford* case. In *Commissioner* v. *Bateman*, 127 F. (2d) 266 (decided April 7, 1942), that Court said at page 271:

> "Frankly we do not know how the Supreme Court would apply the general criteria of the Clifford case to the facts now before us. We have to make our decision with such light as is available to us. * * * "

The Court then carefully reviewed the decisions of this Court and the decisions of various Circuit Courts of Appeals on the same question and added at page 274:

> "This review of the cases still does not indicate to us as clearly as we should wish how the case at bar should be decided."

With obvious misgivings and doubts as to what the correct rule is, the Circuit Court of Appeals in that case then held certain income of a trust not taxable to the grantor, although such income was being accumulated expressly subject to the grantor's power of appointment by will.

In the *Clifford* case, this Court justified its liberalized interpretation of Section 22(a) by the presence of three factors: "the short duration of the trust, the fact that the wife was the beneficiary, and the retention of control over the corpus by respondent" (309 U. S. at p. 335). The questions have been frequently raised but never authoritatively answered:

> " 'How short must be the term of the trust—5 years, 10 years, 15 years, for life? How close must be the familial relationship of the beneficiary—adult son, uncle? How extensive must be the grantor's control? How many of these factors need be present and in what combinations?' Surrey, The Supreme Court and The Federal Income Tax: Some Implications of Recent Decisions, 35 Illinois Law Review 779, 807." [Quoted among a number of other similar excerpts in footnote 11 to the opinion of the Court below (111).]

The present case offers an excellent vehicle for authoritative settlement of these questions by this Court since it involves double the term of the *Clifford* case, much less close family relationship, incomparably less control of the corpus by the grantor and correspondingly greater powers vested in an independent trustee.

Indeed, the decision below is apparently based upon a greatly simplified rule,—a rule that all trusts which may terminate short of a lifetime and which benefit blood relatives of the grantor must be disregarded for tax purposes. We do not believe that is the correct rule or the rule in-

tended by this Court, but we do submit that orderly administration of the tax laws requires that the question be determined by this Court.

(3) *Questions Decisive in the Present Case Have Been the Subject of Clearly Conflicting Decisions in Different Circuit Courts of Appeals.*

The relative importance of the three factors which the rule in the *Clifford* case made decisive of taxability in family trust cases has been the subject of great controversy and divergence of decision in the various Circuit Courts of Appeals. The cases are discussed in more detail in the brief in support of this petition, but a summary of the range of conflict with respect to each factor is as follows:

(a) *Duration of the trust*: The decision below in this case held a term in the alternative of ten years or life to be a short-term trust. The Second Circuit Court of Appeals reached an opposite conclusion as to a ten year term in *Commissioner* v. *Jonas*, 122 F. (2d) 169. The First Circuit Court of Appeals, in *Commissioner* v. *Branch*, 114 F. (2d) 985, and the Second Circuit, in *Helvering* v. *Palmer*, 115 F. (2d) 368, similarly held that trusts for the lifetime of the beneficiaries—the grantor's wife in each case—were not short-term trusts and not taxable to the grantors under the *Clifford* rule.

(b) *Degree of relationship between grantor and beneficiary*: The Court below inferred that all four trusts here involved were for the benefit of the grantor's "intimate family group" although the only evidence offered by the Commissioner (upon whom the burden of proof rested in this case) was that the beneficiaries were the wife and three sons, respectively. The effect of this decision is that the

following facts, which must be assumed on this record, viz., the absence of a legal obligation to support, the fact that proceeds of the trust income were not used for maintenance or support, and the status of the grantor's sons as emancipated adults, are all immaterial in determining taxability under the *Clifford* rule.

In contrast, the Seventh Circuit Court of Appeals in *Commissioner* v. *Armour,* 125 F. (2d) 467 (February 2, 1942), flatly held that a married daughter, who was an only child with no children of her own and who was thirty-four years of age, was not a member of her mother's "intimate family group" so as to make the trust established by the mother for her benefit one taxable to the mother under the *Clifford* rule. The Sixth Circuit Court of Appeals has also emphasized the importance of proof of family solidarity (disregarded by the Third Circuit in this case) in holding not taxable to the grantor the income from trusts for the benefit of his wife and stepsons where it did not appear that such income was necessary for the support of the beneficiaries. *Suhr* v. *Commissioner,* 126 F. (2d) 283 (March 5, 1942).

(c) *Grantor's "control" of the trust property*: The Court below has held that the control retained by Cory was comparable to that considered by this Court in the *Clifford* case. The following chart shows the almost complete dissimilarity of the two cases in this respect:

Facts	*Clifford*	*Cory*
Was grantor trustee?	Yes	No
Did grantor control distribution of income?	Yes	No

Facts	*Clifford*	*Cory*
Investment and voting control	Solely in grantor as trustee	In independent trustee. Grantor had right to direct but did not exercise it.
Were grantor's powers of investment and voting control exercised?	Yes	No
Was grantor's approval necessary for sales or investments?	Yes, because he was the sole trustee	No
Could securities be held in grantor's own name?	Yes	No
Did grantor collect income?	Yes	No
Did grantor have power to compromise claims?	Yes	No
Was grantor protected against any liability except for bad faith?	Yes	No

The decision below is also in conflict with the First and Second Circuit Courts of Appeals as to the element of con-

trol which is requisite to bring a case within the *Clifford* rule. Far greater control was retained by the grantors of the trusts involved in *Commissioner* v. *Branch,* 114 F. (2d) 985 (C. C. A. 1st), *Commissioner* v. *Bateman,* 127 F. (2d) 266 (C. C. A. 1st), and *Palmer* v. *Commissioner,* 40 B. T. A. 102 (1939), affirmed without opinion on authority of *Commissioner* v. *Branch* in *Helvering* v. *Palmer,* 115 F. (2d) 368 (C. C. A. 2d). In all of these cases the trusts involved were held not taxable to the grantor.

Wherefore, your petitioner, referring to the attached brief in support of the foregoing reasons for granting the writ, respectfully prays that this Honorable Court issue a writ of certiorari, directing the United States Circuit Court of Appeals for the Third Circuit to certify and send to this Court a full and complete transcript of the record herein, to the end that the said case may be reviewed and determined by this Court as provided by law, and that the judgment of the United States Circuit Court of Appeals for the Third Circuit may be reversed, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

And your petitioner will ever pray.

Robert H. Cory,
Petitioner.